

## Message Text

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11

ACTION TRSE-00

INFO OCT-01 EA-07 NEA-10 ISO-00 CIAE-00 PM-04 H-02 INR-07

L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

AID-05 COME-00 EB-07 FRB-03 XMB-02 OPIC-03 CIEP-01

LAB-04 SIL-01 OMB-01 CEA-01 STR-04 IO-13 /109 W

----- 077539

R 011115Z SEP 76

FM AMEMBASSY KATHMANDU  
TO SECSTATE WASHDC 6105  
INFO AMEMBASSY MANILA

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E.O. 11652 N/A

TAGS: EAID, EFIN NP

SUBJ: PROPOSED ADB SUPPLEMENTARY LOAN FOR HETAUDA-  
NARAYANGARH ROAD

REF: A) MANILA 12974, B) TREASURY MSG. 251615Z (NOTAL)

C) KATHMANDU A-84, DEC 19, 1975

D) KATHMANDU A-32, JUNE 4, 1976

FOR NAC AGENCIES

1. SUMMARY: SUBJECT PROJECT IS UNQUESTIONABLY WORTHY,  
BUT MAY BE OVER-DESIGNED. ADB STAFF REPORT ON LOAN  
PROPLSAL EXAGGERATES NEPAL'S FOREIGN EXCHANGE CONSTRAINTS,  
BUT REAL ISSUE IN ANY EVET IS NOT FX AVAILABLILITY ALONE  
BUT OVER-ALL STATE OF LOCAL ECONOMY. WHILE IN THE ABSTRACT  
SUBJECT PROPOSAL MIGHT BE APPROPRIATE OCCASSION TO CALL FOR  
EXERCISE OF DISCIPLINE IN REGARD TO COST OVER-RUNS, OUR  
IMPRESSION ISTHAT NEPAL'S RLDC, MSA STATUS ENGENDERS A GREAT  
DEAL OF SYMPATHY AMONG ADB MEMBERS, RECOMMENDNING A MORE  
SOPHISTICATED APPROACH THAN A SIMPLE "NO" VOTE ON THE LOAN.  
END SUMMARRY.

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2. SUBJECT PROJECT IS A KEY LINK IN THE DEVELOPMENT OF NEPAL'S EAST-WEST HIGHWAY, WHICH WILL RUN THE LENGTH OF THE COUNTRY WHEN COMPLETED AND CONSTITUTE THE BACKBONE OF ITS ROAD TRANSPORT SYSTEM. AS NOTED IN THE ADB APPRAISAL, IT IS ALSO VITAL ELEMENT OF THE IMPORTANT CHITWAN VALLEY DEVELOPMENT SCHEME. THERE IS NO QUESTION BUT THAT THE ROADS AS SUCH IS HIGHLY JUSTIFIABLE PROJECT. (THE ORIGINAL GRAVEL ROAD WAS A USAID PROJECT.)

3. HOWEVER, WHILE LACKING THE RESOURCES TO CHALLENGE DIRECTLY WITH TECHNICAL DATA THE ADB STAFF REPORT ASSERTION THAT A REDUCTION IN SCOPE IS NOT FEASIBLE, WE REMAIN SKEPTICAL. THE AVERAGE DAILY TRAFFIC COUNT CITED STRIKES US AS HIGH IN COMPARISON WITH THE REST OF EXISTING EAST-WEST HIGHWAY SEGMENTS, ALMOST AS HIGH AS THAT FOR THE TRIBHUVAN HIGHWAY, KATHMANDU'S ARTERIAL LIFELINE TO INDIA. IT HAS BEEN OBSERVED BY WORLD BANK ANALYSTS, AMONG OTHERS THAT ROAD IN NEPAL IN GENERAL HAVE TENDED TO BE OVER DESIGNED. IN PARTICULAR, THE SEVEN-METER HARD-SURFACE WIDTH FOR THIS PROJECT IS IN CONTRAST TO THE THREE AND HALF METER STANDARD FOR MOST OF THE REST OF THE EAST/WEST HIGHWAY, E.G. THE RECENTLY COMPLETED BRITISH-AIDED SECTOR WITH WHICH IT CONNECTS AT NARAYANGARH. ON THE WHOLE, IT IS OUR NON-TECHNICAL RPT NON-TECHNICAL OPINION THAT THE SCOPE OF THE PROJECT COULD IN FACT PROBABLY BE REDUCED WITHOUT SUBSTANTIALLY AFFECTING THE ECONOMIC BENEFITS OF THE ROAD.

4. REF. B IS A DEPT. OF TREASURY MESSAGE TRANSMITTED DIRECTLY TO THIS POST, QUESTIONING THE FOREIGN-EXCHANGE CONSTRAINT JUSTIFICATION OF THIS LOAN. IN REPLY, IT IS TRUE THAT IN GENERAL, NEPAL HAS TRADITIONALLY ENJOYED AN UNUSUALLY COMFORTABLE CONVERTIBLE FOREIGN EXCHANGE RESERVE POSITION IN COMPARISON TO MOST RLDC'S AND MSA'S AND COULD UNDOUBTEDLY BE FAULTED FOR MISERLY FX MANAGEMENT IN THE PAST. SITUATION IS NO LONGER QUITE SO SIMPLE. IN THE FIRST PLACE, IT'S NOT VALID TO COMPARE RESERVE HOLDINGS TO HARD CURRENCY IMPORTS ONLY. INDIAN CURRENCY RESERVES ARE NEGLIGIBLE, AND HARD CURRENCY POSITION LIMITED OFFICIAL USE

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REPRESENTS ULTIMATE BACKING FOR IMPORTS FROM INDIAN AS WELL AS FROM THIRD COUNTRIES. (IN FACT, HARD CURRENCY DRAWINGS ARE OCCASIONALLY BEING USED BOTH INDIRECTLY AND DIRECTLY IN CERTAIN CASES TO PAY FOR SOME INDIAN IMPORTS.) WHEN COMPARED TO TOTAL RPT TOTAL ANNUAL IMPORTS AT A CURRENT LEVEL OF ABOUT \$165 MILLION, NEPAL'S RESERVE POSITION IS NOT QUITE SO IMPRESSIVE, ALTHOUGH UNQUESTIONABLY STILL RATHER COMFORTABLE. MORE TO THE POINT, HOWEVER, IS THE FACT

JUST ABOUT OVER FOR NEPAL. REFS C & D ANALYZE THIS AT SOME LENGTH. IN BRIEF, THE SITUATION IS THAT NEPAL IS FACED WITH STATIC OR SHRINKING HARD CURRENCY INCOME FROM EXPORTS AND PRIVATE TRANSFERS (GURKHA REMITTANCES), LEAVING ONLY TOURISM AS A (NON-AID) GROWTH EARNER TO BALANCE RAPIDLY EXPANDING IMPORT EXPENDITURE. EMBASSY IS PREDICTING MODERATE TO SIGNIFICANT DECLINES IN NEPAL'S FX POSITION OVER THE NEXT 5 YEARS. NEVERTHELESS, IT IS CLEAR THAT NEPAL COULD FINANCE THE SUBJECT COST OVER-RUN FROM HER OWN RESERVES. THE REAL ISSUE IS NOT FX AVAILABILITY AS SUCH, BUT RATHER RESOURCE TRANSFER FOR A LEAST-DEVELOPED, LAND-LOCKED COUNTRY WITH A VERY SHAKY AND LARGELY SUBSISTENCE ECONOMY.

5. ABOVE COMMENTS NOTWITHSTANDING IT REMAINS OUR OPINION THAT THE PROJECT IS PROBABLY OVER-DESIGNED, AND THAT COST OVER-RUNS AND GENERAL GOVERNMENTAL ADMINISTRATIVE SLACKNESS IN BOTH ADB AND OTHER FOREIGN AID PROJECTS IS FREQUENTLY A SERIOUS PROBLEM IN GENERAL IN NEPAL. THE QUESTION IS WHETHER THIS IS AN APPROPRIATE OCCASION ON WHICH TO ATTEMPT TO ENFORCE A DISCIPLINARY LESSON. OUR IMPRESSION OF THE CURRENT MOOD IN THE ADB IS THAT NEPAL'S LANDLOCKED LLDC AND MSA STATUS QUALIFIES HER FOR GENEROUS AND FAIRLY UNCERITAIN DOSES OF RESOURCE TRANSFER AND THAT U.S. OPPOSITION TO THIS AMIDST CRIES OF "HEARTLESS BRUTE\*" IF NAC SIMPLY WELCOMES OPPORTUNITY FOR SYMBOLIC PROTEST AGAINST LAX LOAN POLICY, THIS WOULD BE AN APPROPRIATE CASE ON WHICH TO CAST A NO VOTE. IF DESIRE IS TO REALLY EXERT A SALUTORY INFLUENCE, WE SUSPECT THAT A MORE SUBTLE APPROACH WOULD BE NECESSARY. WE ARE NOT SUFFICIENTLY FAMILIAR WITH THE REAL POLITICK OF ADB TO MAKE SERIOUS SUGGESTIONS IN THIS REGARD. THE ONLY THOUGHT WHICH OCCURS IS TO ACCEDE TO THE LOAN BUT TO PROPOSE IT BE MADE FROM ORDINARY LIMITED OFFICIAL USE

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FUND RATHER THAN SPECIAL FUND, OR OTHERWISE HARDEN TERMS SO AS TO PUT A LITTLE BITE INTO THE CONSEQUENCES OF OVER-DESIGN AND OF COST OVER-RUN.

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## Message Attributes

**Automatic Decaptoning:** X  
**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
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